

LAUNCHING REHABILITATION : AN INTEGRATED PROGRAMME FOR THE NEXT SIX MONTHSThe Starting Point

28. When the Team arrived in Kampala, the UNLF had been in power for just one month, and faced immense difficulties. Most of the ministers and permanent secretaries had not had much previous experience of government. Moreover, the only administrative practices with which many of their officials, especially the younger ones, were familiar were the peculiar ones of the previous regime. When the new ministers moved into their offices in April, they found these completely ransacked, with few chairs left, or desks or typewriters or pens or even sheets of paper. Some had to spend time and energy on personal problems - relatives missing, homes looted, cars stolen. The telephone, rail and road systems were disrupted; indeed a large part of the country was still in enemy hands. It was hard to know what was happening, or even had been happening; many records had been destroyed and statistical series were either not available or of little value.

29. We were impressed with the progress in recreating an administrative machine in such a short time and such difficult circumstances. Lines of responsibility had been established; papers circulated before meetings; ministers were briefed. The machine had begun to work.

30. There had also been some progress on the economic front. Goods were trickling in. The petrol shortage had eased. A few lorries and cars had been driven over from Kenya. Although the black market value of the Uganda shilling was only approximately one-sixth of the official rate, this was about twice what it had been. Food prices had dropped back from their peaks; the price of sugar, for example, fell from nearly Shs. 100 a kg. in December to Shs.40 in May.

31. But these economic improvements were somewhat superficial. The economy was - and is - still gummed up. Most factories are only working, if at all, to a fraction of their capacity. Many farmers have not been able to plant cash crops such as cotton and tobacco; others are unable to market the crop they have picked. Workshops remain idle. Shops are still empty. The road back to 1970 is still a long one. Decisions on economic policy are urgently needed, as well as action to raise resources overseas.

32. The chief requirement for getting the economy working again is a big flow of imports. If items like cooking oils, salt and a few other necessities were imported in quantity, prices would decline, wages would buy more and so would farm incomes - work would be worthwhile.

33. Imported materials and tools such as hoes are needed for people to work with. Spare parts would enable machinery and vehicles to be brought back into working order. A little foreign exchange could provide a big yield in increased production. As local output rose there would be another source of supply for consumer markets, further reducing prices and limiting opportunities for magendo. The cumulative upswing would have begun. It urgently needs starting and we consider in this chapter a plan for doing so this year.

34. We estimate the need for imports in the period July - December as follows:

	<u>Shs.m.</u>
consumer goods	780
Petroleum and products <sup>a</sup>	480
Inputs for agriculture	440
Inputs for manufacturing and other industries <sup>b</sup>	790
Transport equipment and spare parts	880
Water and Sewerage	70
Telecommunications	230
Housing	590
Social services and administration	540
Miscellaneous	170
	<u>4,970</u>

<sup>a</sup> Includes an agreed phased repayment of arrears to the oil companies

<sup>b</sup> Includes minerals, power and tourism.

We have scrutinised each category separately and come to the conclusion that this is about the minimum that would permit the rehabilitation to be launched.

35. The estimates of consumer goods imports refer only to basic necessities (salt, sugar, soap, cooking oils and fats, clothing, sewing machines, skimmed and condensed milk, radios, batteries and pharmaceuticals). The per capita consumption of these goods attainable with imports at this level would be comparable to that of 1971,<sup>1</sup> with an allowance for the rebuilding of inventories, one of the necessary steps in eliminating the black markets.

36. Inventories of industrial materials are running low. Many factories will have to close down in a few weeks if they cannot get materials, including heavy industries such as those producing cement and hoes. Others (e.g. Tororo Steel) are closed already. (See section 3 in Paper 11 on the main industrial sectors). Spare parts are also widely needed if production is to rise towards its former level, thereby further easing the prevailing shortages of goods, saving imports, and supplying jobs to those Ugandans returning to the cities from the countryside and abroad. Without agricultural inputs, the recovery of the export sector, particularly in the first instance coffee, would be inhibited by low yields, inadequate processing capacity, insufficient bags, and the like. The imports of transport equipment are absolutely fundamental to the recovery programme; they would permit the crucial movements of coffee from farms to export markets, and of consumer goods and industrial inputs in the reverse direction (see below). They include 65,000 bicycles and 1,300 motorcycles.

37. There are pressing needs for new equipment and materials in passenger transport, water and sewerage, health, education, housing and other forms of infrastructure. These are detailed in the next chapter, not being integral parts of this initial push, but some of the most urgent requirements are included in the preceding list.

38. It would not be difficult to add to the priority import bill shown here. Allowance has been made only for necessities, especially of consumer goods.

#### Breaking Transportation 'Bottlenecks'

39. The difficulties in arranging the necessary flood of imports are twofold: transportation and foreign exchange. Transportation is always a special concern in a landlocked country, but, up to mid-June, it would hardly have needed emphasis because Kenya Railways was still insisting on pre-payment, not merely of rail freight but also of arrears of demurrage charges, amounting to Shs.25m. So the hold-up was basically an issue of foreign exchange. We gather that this has now been largely waived, a very helpful gesture.

40. Attention can now shift to the 'bottlenecks' in the movement of imported merchandise (See Paper 16). One is the change of locomotives at the border. An arrangement with the Kenya Railways should obviate the delays here; otherwise the flow of goods would be checked again soon after it started. It is not as if the two railways had different gauges. A more rational arrangement would be for the heavy locomotives based in Kenya to come right through into Uganda (as a few do already), particularly in view of a length of steep gradient on the Ugandan side.

41. The next question is whether the transport system inside Uganda could handle a normal inflow. There seem no basic problems about the equipment of the railways - it was difficult to loot locomotives and wagons. Moreover, considerable new rolling stock has recently arrived or is on its way. Provided the oldest diesels can be overhauled (a high priority), the motor power and wagon capacity would be comparable to that of 1970 and adequate for the period of rehabilitation. However, technical assistance is badly needed in signalling, telecommunications and both mechanical and electrical engineering.

42. A more serious problem is the capacity of the system of road transport to move imports, especially into the rural areas, where they are badly needed (See Paper 18).

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<sup>1</sup> A more convenient year than 1970 for this purpose.

The roads themselves are in a parlous state, as a result of years of neglect. Some, the East-West main road in particular, have had to suffer the long-distance heavy lorries running through to Burundi, Rwanda and North-East Zaire. A number were further damaged by the recent movements of the tanks and other military vehicles and, in some cases, by shelling.

43. A big increase in their use would hasten the deterioration of the roads, perhaps critically. Pot-holes urgently need filling, shoulders reinstating, drains clearing; throughout the country, murrum roads need regrading. Nevertheless, we are convinced from our journeys over most of the country, that though considerable technical assistance is needed at both professional and technical levels, more imports could be brought to the rural areas - even if with difficulty and at high cost. (For details of road conditions and proposals, see Paper 17).

44. So we come to vehicles. There are approximately 1,600 heavy lorries in Uganda at present, a fifth of the fleet in 1970 (or half the number on the road last December). This is not enough; even at the present low level of trade, it is necessary to hire lorries (mainly from Kenya) at heavy foreign-exchange costs. We gather that altogether 150 Tata lorries are in either Kampala or Mombasa ready for use. In addition, another 250 are awaiting in India for shipment when the remaining payments (about Shs.100m) are made, and could arrive in Mombasa by early August.

45. Even a total fleet of 2,200, however, many of them new, would not be adequate for the rehabilitation needs of the next few months, especially if the road system is not quickly repaired. Since there is also a shortage of service facilities, a large proportion of the lorries will frequently need expensive spare parts. Many may well have to be scrapped abnormally early. Big new orders will need to be put in hand very soon, if this is not to remain a 'bottleneck'.

#### Export Earnings

46. So the real 'bottleneck' is foreign exchange (See Paper 25). In normal conditions (viz. as they were in 1970), one would expect Uganda quickly to be able to resume exporting its chief cash crops and copper, and to reactivate its tourism on a scale sufficient to meet a large proportion of the bill for imports of both normal supplies and those needed for rehabilitation, especially transport equipment.

47. Transport 'bottlenecks' are an obstacle to exporting as they are to importing. Space is especially important for bulky crops. At present, though Kenya Railways have offered to consider five trains a week, only two are actually running. And the state of the roads and the shortage of vehicles reduces the export potential too, with the added problem that a lack of bicycles and pickups is cutting the flow of coffee from the farms to the societies and factories.

48. Very few copper exports can be expected in the remainder of this year because, even though the rail line to Kilembe is apparently working again, both the mine and the smelter will be held up for lack of materials and spare parts, indeed proper machinery. There will be considerable delays in reviving tourist traffic on the scale of 1970 - if not for reasons of confidence, then simply because it will take time to restore the looted hotels.

49. This takes us to the cash crops where the main problem is producer prices (See Papers 4 and 25). In the case of cotton, the earliest impact that a further price increase is likely to have would be on the crop to be planted in 1980, which will not be processed and ready for sale until half-way through 1981. Some reduction in border smuggling to Kenya could follow from an improvement in the supply of consumer goods, but the extra official foreign exchange receipts would be small. Improved prices for tea could lead to a positive response within the six month period, even from the abandoned plots, but again the absolute increase in foreign exchange earnings cannot be great.

50. The producer price for coffee is the real issue, even in the very short run. This is not because of any expectation that it would evoke a quick response in terms of supplies. The reason is the risk of the resumption of smuggling - whether organised on a large scale by a new in-group or through a resumption of the small scale head-load

and bicycle-load border crossings of 1976/77 - unless prices in Uganda are brought closer to those prevailing across the international frontiers with Kenya (especially), Tanzania, Rwanda and Zaire.

51. The effects of price changes are difficult to estimate precisely, but we believe that for the export sector to be rehabilitated the following increases are needed immediately:

	(Shs. per kg.)	
	<u>Current</u>	<u>Proposed</u>
Coffee (robusta dried cherry) <sup>a</sup>	3.50	7.00
Cotton (clean seed)	5.00	6.00
Tea (green leaf)	1.25	2.00

<sup>a</sup> With corresponding increases in arabica parchment.

52. Assuming that coffee growers will receive increased incentives, and that the coffee transport and processing problems internal to Uganda are resolved over the course of the next few months, it should be possible gradually to expand coffee sales to nearly normal levels by the end of the year. But it will take time to get existing stocks out of the country and to rebuild the capacity to move and process more. There is typically a further delay between shipment and the receipt of foreign exchange. Despite the recent fortunate increase in world coffee prices, foreign exchange earnings from coffee will still be limited during the vital period of the next six months. Our working assumption is that the average price will be in the range of Shs.25,000-30,000 per tonne. So one can only expect exports of coffee to yield Shs.1,500-1,800m in the next six months, and total exports to be no more than Shs.1,620-1,920m.

53. Moreover, there are other foreign exchange liabilities. As we pointed out in paragraph 19, the UNLF inherited unpaid bills and debt obligations to the tune of at least Shs.1,000m, nearly half owed to foreign governments (See Paper 27).<sup>1</sup> Few of these have been paid. In addition, servicing the public debt would normally cost about Shs.150m in the coming six months, of which one-quarter would be in respect of loans made in the later years of the military regime by the so-called 'friendly' countries (which between them also account for over Shs.70m of the defaulted debt service).

54. It would be difficult to delay payment on commercial arrears (clearing and forwarding, foreign airlines, etc.). However, the Uganda Government would be in a strong position to insist that some government debts should be cancelled and that it should not be expected to pay off at once any of the inherited arrears. Particularly debts incurred in the closing years of the military regime made little contribution to the development of the country, indeed perhaps the contribution was negative, some being used in fact or in effect to enhance the power of dictatorship.

55. In the case of other creditor governments, the same objectives could be sought on the basis of different arguments. They all have an interest in helping set in motion an upward spiral of activity so that Uganda can take its place again as an economically viable member of the world's trading community. Uganda is a 'least developed' country and many creditors have announced policies of cancelling the debts of countries in this category; some have specifically done so for Uganda. A moratorium should be declared on the remainder, on the understanding that it would be a matter of temporary necessity.

56. It would, however, be unwise to default unilaterally on current servicing of debts, at least when these are to governments with which there are expectations of normal diplomatic and trade relations, or to companies from which further supplies will be needed. However, governments should be requested to forego such payments voluntarily.

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<sup>1</sup> Arrears on oil are not included - an agreed programme of paying overdue and current bills has been negotiated; the figures are included in those given for petroleum products, in paragraph 34 above.

57. If these tactics are pursued for debt obligations past and present, it would be necessary to allow in this period, not Shs.1,100m. but say Shs.520m., going only to commercial creditors. In addition, payments on 'invisible' account (current costs of freight, airline charges, etc) would amount to about Shs.530m.

58. To summarise, the current account balance for these six months, if exports get moving and imports are resumed on the minimum but sufficient scale we have suggested, would be as follows:

(Shs. m.)			
Imports	4,970	Exports	1,620 - 1,920
Commercial debt arrears and servicing <sup>a</sup>	520	Invisibles <sup>b</sup>	40
Other invisibles	530	Current account receipts	1,660 - 1,960
	6,020	Deficit	4,360 - 4,060
			6,020

a Other than payments on debts to oil companies, included under imports

b Tourism, transit fees and electricity sales to Kenya

59. In brief, exports can only be expected at best to meet less than one-third of the essential goods and services compatible with the needs of rehabilitation. The bulk of imports will need to be financed in some other way. There are already firm offers of grants and loans from British commercial banks, the Government of India, the EEC and UNICEF totalling about Shs.550m. (apart from what has been received from the Government of Kenya, Tanzania and Britain, the IMF and Barclays Bank, totalling Shs.229m.), though some of these funds are tied to particular long-term development projects and cannot be used to finance the deficit shown above.

60. In addition, however, there are possibilities of further assistance from the IMF through its normal lending operations, its 'compensatory financing' facility and its Trust Fund, and Uganda could also draw down the remainder of its entitlements to Special Drawing Rights. On the face of it, the Government is also eligible for grants under the STABEX arrangements of the Lomé Convention (particularly if the provisions for 'special cases' are supplied). IMF and STABEX support could total as much as another Shs.300m. if exceptional efforts are made to obtain this support in the next few months.

61. Another possible source worth considering in the present extremity is forward sale of part of coffee exports, once they are flowing out again, provided of course this seems justified by market trends.

62. Let us take the total usable to meet the deficit from all sources in the three previous paragraphs as Shs.1,000m. That leaves at least Shs.3,000m. still to be financed. Possible sources include private direct investment, trade credits, bank loans, further assistance from foreign governments and the IMF. To support its case for inflows of any of these types the Government can point not only to the economic and political importance of the country's rehabilitation but also to its commitment to a mixed economy; and to the basic strength of its economy, especially the further 100,000 tonnes or more of coffee which could well be sold during the first half of 1980, generating foreign exchange earnings of at least another Shs.2,500m. Exports of tea and cotton should be starting again in quantity in 1981. The rehabilitation of copper and tourism should, in due course, be reflected in foreign exchange receipts. (The next chapter gives short-term projections for all of these). There are also excellent longer run prospects for cobalt (See Paper 12). Finally, the total indebtedness of the Government is in fact relatively low, despite the foreign borrowing of the military regime.

63. Not much private direct investment can be expected under present circumstances. Trade credits and bank loans are already being explored, with a British bank's assistance, and these explorations need pursuing vigorously. But these sources of money are of course expensive; if one relied wholly on them their servicing would constitute a heavy burden on the balance of payments, even in 1980. The more one borrows, after a certain point, the more expensive it becomes, and finance of this kind is not in fact likely to be available in large quantities. Let us allow very roughly Shs.1,000m. under these headings.

64. If Uganda is to achieve the essential level of imports and get started on rehabilitation, there is therefore no doubt about the need for official aid, not primarily project aid but temporary balance of payments support. The country's immediate needs greatly exceed its immediate capacity to finance them and it follows from the logic of the argument above that at least Shs.2,000m. is required in this form of support - more if many government creditors insist on prompt payment of arrears. In considering such matters, donors might reflect on the fact that Uganda was not receiving the usual amount of aid in the dying years of the military regime.

65. Even within this six month period there are problems of timing. In the first three months, the exports would be less than half the total for the half year, while import needs would be more than half. Moreover, it would be difficult to mobilise much of the IMF facilities in this period. It is now that special balance of payments support is necessary.

66. The failure of the new Government visibly to be achieving quick rehabilitation could generate disaffection. There is no time to be lost if Uganda is to avoid sliding back into the economic and political turmoil from which it has so recently emerged. This is a case where each pound or dollar or mark made available now might be worth several times what it would be if offered in a few months' time.

#### Administrative Problems of the First Phase

67. A number of special administrative problems will arise for the Ugandan Government out of the programme outlined above (See, particularly, Paper 29). In the first place, proper arrangements need to be made for foreign exchange control which must give due weight to import licensing policy. The proposals for balance of payments support would make even more important the choice of proper mechanisms for the type of aid programme proposed - the donors would doubtless require some special guarantees against wastage, e.g. the appointment of a joint donor-recipient committee.

68. It is important that the foreign exchange for consumer goods in particular, as well as for industrial materials destined for private contractors and some parastatal bodies, should not simply be made available at the official exchange rate. This is what the military regime did (when it had any foreign exchange) under the pretence that the goods concerned would in due course be sold at controlled prices. The effect was magendo and the enrichment of the few.

69. It would be the same today, and very largely the same people would gain. The dangers of corruption spreading once more in the ministries would be serious. A foreign exchange license for Shs.100 is in fact also a gift voucher for Shs.500, and the temptation, especially for officials whose real salaries have shrunk, to 'allocate' it to a relative, or to require a 'kickback', would be immense. As one consequence, those supplying aid would be discouraged if they saw much of it passing into the hands of speculators.

70. Provided it were administratively feasible to ration essential consumer goods through the coming months, that would be a possible solution; but this is obviously not feasible. A devaluation would be an alternative solution, but to solve this problem it would have to be greater than is necessary for other purposes: the black market really provides no clue to what an 'equilibrium rate' would be. Another way of dealing with the problem would be for the Government to auction the foreign exchange entitlements, trying to ensure that competition really reigned (e.g. by holding some auctions outside Kampala) and take for itself what would otherwise leak out in magendo. A further option would be for the Government to levy taxes roughly equivalent to estimated magendo profits.

71. These last two alternatives would of course involve abolishing retail price control and open the Government to the charge that it was itself responsible for higher prices. Still there is little reason to expect that any of the procedures suggested above would actually increase prices - or only for a very short period. On the contrary, our programme would make possible a growing flood of imports - and generate the confidence that they would continue to grow - inducing a declining trend in prices from their present absurd levels. Therefore few retail purchasers would consider themselves any worse off. We presume that the Government has room to manoeuvre to start pulling down the economic facade of the Amin regime. The removal of price controls, especially those that have no practical effect, is a vital early step.

72. There would be other problems to solve. It would not be enough merely to make imports available, because many businesses, private and public, would not be able to buy them. In the first place, the banking system would need to resume its traditional role as a body financing private imports, if necessary with encouragement from the Bank of Uganda (See Paper 26).

73. Secondly, the financial state of many parastatals is serious. It is tempting to conclude that the only solution is either to sell these quickly to whoever would buy them or close them down. We shall argue later that a body should be set up in the near future to review the parastatals and make recommendations about their future (See Paper 9). However, this is also something not to be done in a rush. A generally disorderly denationalisation could cause as big a dislocation as the disorderly nationalisation of 1972. It would be particularly dangerous in the months immediately ahead when a growing output is urgently needed. Many of the properties would moreover fetch very low prices in the present state of the economy. Paradoxically, whilst reducing the public sector would help eliminate magendo, the process of doing so could provide the most striking example of profiteering.

74. There still remains the basic problem of starting up industrial operations again, which is primarily a matter of finance. An obvious solution would be a moratorium (which cooperatives also need) to relieve indebtedness and enable this sector to order imports. However, it should only apply to debts to the Government and to banks, because in many cases a moratorium on all the debts of one parastatal would aggravate the financial problems of others. One of the first functions of the body proposed (paragraph 73) should be to study the balance sheets and suggest how to unravel the complex liquidity problems of this whole group. Moreover, even a limited moratorium reinforces the need for proper supervision of management by ensuring that effective boards are set up.

75. A number of interrelated components of the first stage of rehabilitation have now been mentioned - supply of imports, rail transportation, road fleets, export crops, foreign credits, corporate liquidity. Some way needs to be found of monitoring this stage so that inconsistency does not arise between different departmental policies, crucial 'bottlenecks' are identified as soon as they occur, and action is organised to deal with them. We suggest an inter-departmental committee meeting weekly, chaired by the Secretary to the Treasury.

76. But such a committee needs an operational arm - a government task force with sufficient authority and executive powers to tackle the problems of transportation, logistics and related activities to ensure that essential exports and imports flow expeditiously and without interruption. The task force would not necessarily consist only of public servants; it could include specialists in shipping, forwarding, cargo handling, warehousing and customs operations.

#### Fiscal Implications of the First Phase

77. The programme would also affect government finance. It implies reducing the export tax on coffee, and raising the subsidies on cotton and tea. To the extent that the intended effect, increased output, is achieved, the consequence would be a large increase in the subsidy bill for tea. (Output of cotton is too low for this to make much fiscal difference this year). In the case of coffee, the reduced government take per bag would be partially offset by the increasing number of bags passing through official channels. In any case, the possible increase in the world price might raise revenue substantially - though if that happens, further increases in the buying prices might be needed to avoid too large a contrast with what could be obtained for coffee in Kenya.

78. Essentially, what is involved is higher rural incomes at a time when large general increases in consumption cannot be afforded, so there need to be offsetting sacrifices elsewhere. To put the same point in fiscal terms, the loss of revenue caused by the adjustment of producer prices, needs to be offset by higher government income from some other source.

79. There are basically two ways of doing this - raising indirect taxes or devaluing the shilling (See Paper 25). They should be seen as two ways of achieving the same objective, whether this is put in revenue or 'real' terms. Devaluation would raise revenue by increasing the yield of the tax on coffee (and it would also reduce expenditure on subsidising tea and cotton). Both of them would cut into magendo profits, to the extent that the resultant import price increases were not 'passed on'.

80. We realise that this is essentially a political question. There are psychological overtones to the word 'devaluation', especially in view of its well-remembered political consequences in Ghana and elsewhere in Africa, and there would be strong opposition from the interests that would suffer. But devaluation would be the more effective. It would automatically raise returns from all exports in local currency, including some not reached by price policy, such as tourism and manufactures. Similarly, it would raise the cost of all foreign exchange outlays, and increase the profitability of import substitutes, such as sugar and tobacco. It would need much less administration, and one of the greatest needs is to relieve an overloaded bureaucracy.

81. It is in any case not necessary to make a straight choice. If taxes are raised, any devaluation need be by that much less.

82. Fiscal policy in this period faces a very difficult dilemma. If it is too restrictive, it will block the recovery; if too expansionary, it will fuel inflation and perpetuate magendo, which will also impede rehabilitation.

83. The major requirement is to bring an end to budget deficits and illegal recourse to 'ways and means' financing (which already far exceeds its statutory limits) in order to demonstrate that that whole shabby period has ended. This means a very limited budget in the first place, including only what expenditure can be covered by taxation (allowing for the effects of a higher buying price for coffee) thus leaving out the bulk of rehabilitation spending. This can be afforded as and when foreign aid is provided.

84. The grants and loans indicated above (together with the moratorium) would enable goods to enter markets without a corresponding increase in purchasing power. In fact, such financial flows could be taken into the revenue side of the Government's accounts and permit an extension of expenditure. So could the profit from the scheme of re-selling consumer goods mentioned above (whether taxes or auctions are the chosen instrument). These items cannot of course be entered in the Budget which is now due, because they are speculative. So we recommend a Supplementary Budget, also balanced, in two or three months' time when the scale and nature of aid is clear (For recommendations on these budgets, see Paper 27).